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Fertiliser sector reforms are full of contradictions

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IN his Budget speech, the finance minister announced the government's decision to replace the unit-wise retention pricing scheme (RPS) by a group-based urea concession scheme. He also stated that concessional rates under the scheme would be determined on the basis of the prevailing import parity price (IMPP) for feedstock. Since, both these announcements are based on the Expenditure Reforms Commission (ERC) recommendations, it may be worth examining these.

For determining concessional rates under each of the five groups viz., pre-1992 gas-based plants, post-1992 gas-based plants, naphtha-based plants, plants based on fuel oil/LSHS and plants based on mixed feedstock, the ERC has taken a weighted average of retention prices (RP) of plants under the existing dispensation. This method is flawed as it ignores the wide variations in reasonable production cost within each group caused primarily by differences in the feedstock cost.

While, adoption of this method will not result in any savings in overall subsidy payments which merely gets re-distributed from plants having RP higher than weighted average to those having RP lower than weightage average, it will confer unintended gains on the latter and penalise the former. The averaging concept could have some validity if plants had been similarly placed in respect of cost of feedstock/energy which is not the case.

Consequently, the country will lose about 30-40 per cent of domestic production necessitating extra imports to meet demand. In turn, this will lead to sharp increase in the global price of urea. The government will end up subsidising global suppliers to a great extent.

Having determined the rates using the above methodology viz., Rs 8,400 per tonne for plants in the naphtha group, the ERC further recommends a reduction of Rs 1,900 per tonne to account for the substitution of actual feedstock cost to the units by the IMPP price of feedstock. While, this will aggravate the loss of the losers under the averaging principle, it will also nullify, to a considerable extent, the potential gain of the gainers.

It is illogical to make adjustments on account of IMPP when fertiliser units are not actually getting feedstock at that price. The observation made by the ERC that units should make efforts to procure feedstock at this price is not valid, as under the Exim Policy, they are not even permitted to freely import naphtha. Reportedly, the government is contemplating ensuring supplies of feedstock at IMPP plus 4 per cent sales tax. However, given the pace at which things move within the bureaucracy, it would be long before units actually start getting feedstock at this price.

VIEWPOINT

Let us take a look at the method used for working out the quantum of reduction in concession on account of substituting IMPP with the actual cost of feedstock. For this purpose, the differential in cost—expressed in Rs per million K.cal—is multiplied by total energy consumed per tonne of urea. Thus, taking the former as Rs 100 per million K.cal and latter as 8.0 million K.cal, the reduction will be Rs 800 per tonne of urea.

The method is flawed as it assumes that the entire energy requirement of the plant is sourced from the relevant feedstock for the group in which it falls i.e., naphtha in the instant case against actuals being significantly lower. Depending on the plant configuration, 1/2 to 2/3rd of total energy is supplied from naphtha, the balance comes from use of fuel oil/coal or power sourced from state electricity boards (SEBs). This results in reduction of a much larger quantum than justified.

In the above example and taking only 50 per cent of energy supplied from naphtha i.e., four million K.cal, the reduction on account of the differential of Rs 100 per million K.cal should only be Rs 400 per tonne urea. Against this, according to the method adopted by ERC, the reduction will be Rs 800 per tonne. In other words, there will be an excess disallowance of Rs 400 per tonne.

The ERC has also recommended that whenever there is reduction in IMPP, the concession amount will be correspondingly reduced. These adjustments will be made on quarterly basis. But, when, IMPP increases, the manufacturer will have to recover the corresponding increase in production cost from the farmer by way of increase in selling price. These adjustments will be made on half-yearly basis.

In the scenario of decrease in IMPP, units will suffer on account of the flawed method. In case of increase, too, they will suffer as it will not be possible for them to pass on the higher burden to farmers. This has to be viewed in the light of a parallel recommendation by the ERC for an increase of 7 per cent per annum in selling price. When, even this has not been implemented—for fear of political backlash—it will be willy nilly impossible to hike the price on account of increase in feedstock price, which could be much more.

It, therefore, follows that the ERC report is saddled with contradictions. Its adoption could ruin most of the efficiently run plants, reduce domestic availability of urea and make the country heavily dependent on imports. The government should get the ERC report/recommendations re-examined with a view to removing the anomalies and evolving a new policy which ensures continued health and growth of the industry.

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